

February 4, 2004

OIL AND GAS DOCKET NO. 01-0236356

APPLICATION OF L.O. OIL AND GAS, L.L.C., TO CONSIDER AN EXCEPTION TO STATEWIDE RULE 21 TO ALLOW PRODUCTION BY SWABBING, BAILING, OR JETTING OF WELL NO. 4 ON THE BROWN "B" (13725) LEASE, MARSHA FIELD, BASTROP COUNTY, TEXAS

APPEARANCES:

FOR APPLICANT:

Lloyd Muennink
Mike Akin
Lee Otis Carter

APPLICANT:

L.O. Oil and Gas, L.L.C.
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PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE OF REQUEST FOR ACTION:	September 11, 2003
NOTICE OF HEARING:	October 3, 2003
DATE CASE HEARD:	November 3, 2003
HEARD BY:	Mark Tittel, Hearings Examiner Thomas Richter, Technical Examiner
PFD PREPARED BY:	Mark Helmueller, Hearings Examiner Thomas Richter, Technical Examiner
PFD CIRCULATION DATE:	February 4, 2004

STATEMENT OF THE CASE

L.O. Oil & Gas, L.L.C. (hereinafter "L.O.") has applied for an exception to Statewide Rule 21 to produce Well No. 4 on the Brown "B" (13725) Lease, Marsha Field, Bastrop County, Texas (hereinafter "subject lease" and/or "Brown No. 4") by regularly jetting the well with a mobile compressor, a production method commonly referred to as "air-jetting". This unopposed application seeks authority to use air-jetting as a production method following the Commission's adoption of amendments to Rule 21 in October 2002. The examiners recommend that L.O.'s application be denied because it is not supported by competent technical evidence that an exception is necessary to either prevent waste or protect correlative rights.

SUMMARY OF EVIDENCE

The examiners took Official Notice of the evidence, Proposal for Decision, and Final Order in Oil & Gas Docket No. 01-0235777, in which the Commission recognized L.O. as the operator of the subject lease and the Brown No. 4 well. L.O. filed its first Commission Form P-5 (Organization Report) on July 10, 2003 and posted financial assurance in the form of a \$25,000 Letter of Credit. The Commission determined in Oil & Gas Docket No. 01-0235777 that L.O. possessed a good faith claim of the right to operate the subject lease by virtue of a lease obtained from the mineral interest owner on July 25, 2003.

As noted in the Findings of Fact in Oil & Gas Docket No. 01-0235777, the Brown No. 4 well was drilled by Avian Tech International, Inc. to a total depth of 2430 feet. The well was perforated and completed on May 14, 1993 in the Marsha Field. The well is currently equipped with 150 feet of 2 3/8 inch tubing, and is connected by 3000 feet of flow line to a tank battery. The Commission found, based on L.O.'s own testimony, that the Brown No. 4 well should not be plugged because it could produce up to 30 bopd if equipped for pumping production.

Additionally, at L.O.'s request, Official Notice was taken of a memorandum prepared by the Oil and Gas Division Field Operations Section, which noted that Field Operations did not object to consideration of the well for an exception to Rule 21. However, the memoranda further observed that L.O.'s estimated production of 150 barrels per month was evidence "that conventional methods of production could be used to produce this well without being uneconomic."

In both hearings involving this well, L.O. claimed it restored flowing production in the Brown No. 4 by injecting compressed air in the casing of the well. To determine if the well was capable of production, L.O. connected a gas-powered air compressor to the casing valve in order to inject air into the casing. When 60 psi was reached, the tubing valve was opened and oil flowed to the tank battery. During a six week testing period, air-jetting the well resulted in the production of approximately 140 barrels of oil.

L.O. testified in both hearings that the oil being produced from the subject well is migrating into the wellbore from the Austin Chalk formation. L.O. also presented a copy of a gravity survey which it contended shows that the Brown No. 4 is completed at a structural high in the reservoir.

L.O. raised several confusing and contradictory contentions in support of its request for an exception to Rule 21. L.O. initially asserted that the well could be restored to pumping production as the reservoir had "healed itself" of damage caused by prior improper reservoir management. However, L.O. claimed that even though substantial reserves remained in the Marsha Field, it was unable to determine the volume of any remaining recoverable reserves underlying the lease because the prior operator improperly reported production from Well No. 4 to wells on an adjacent lease.

While admitting that the well could be restored to pumping production, L.O. testified that estimates it obtained to equip the well totaled \$40,000. L.O. urged that the Commission grant it authority to produce the well by air-jetting because it lacked the funds to properly equip the well at this time. Several times during the hearing, L.O. acknowledged that the only thing preventing it from equipping the well with a pumping unit was the lack of funds.

L.O. also argued that paraffin accumulation on the pumping equipment would inhibit production if the well was reequipped and produced on pump. No technical evidence was provided to support this claim, however, L.O. testified that two of its shut-in wells completed in the Marsha Field are on pump, but cannot be restored to production without first treating the wells for paraffin accumulation. Contrary to the initial position taken by L.O. concerning pumping production, L.O. claimed that it would actually produce more oil by air-jetting than by pumping because the lack of reservoir pressure would result in rapid paraffin accumulation which would restrict pumping production.

Finally, L.O. argued that production by air-jetting was necessary to protect correlative rights even though it admitted that there are no other active wells in the Marsha Field. Contrary to its prior assertions that a substantial volume of oil remains in the reservoir, L.O. then claimed that it was skimming the last oil off the top of the reservoir. L.O. also contended that the mineral interest owners will be denied an opportunity to recover their fair share of reserves because it is impossible to get the required reservoir data to support equipping the well with a pump.

AUTHORITY

Statewide Rule 21(k) provides in pertinent part:

Swabbing, bailing, or air jetting of wells is prohibited as a production method for wells unless the Commission has after notice and hearing, granted an exception to this subsection. The Commission shall give notice of the hearing at least 10 days prior to the date of the hearing.

(1) An operator seeking an exception to allow swabbing, bailing, or air jetting of a well shall:

(A) provide the Commission with the names and mailing addresses of the mineral interest owners of record and surface owners of record of the lease on which a well for which an exception is sought is located;

(B) present evidence at the hearing establishing:

- (i) the method of production proposed;
- (ii) that any production is properly accounted for pursuant to §3.26 of this title (relating to Separating Devices, Tanks, and Surface Commingling of Oil);
- (iii) that the proposed exception is necessary to prevent waste or protect correlative rights;
- (iv) that wellhead control is sufficient to prevent releases from the

well;

(v) that no pollution of usable quality water or safety hazard will result from either the proposed production method or the condition of the well; and

(vi) that the operator possesses a continuing good faith claim to the right to operate the well.

EXAMINERS' OPINION

The examiners recommend that L.O.'s application be denied because L.O. failed to present sufficient evidence that the proposed production method for the subject well was necessary to prevent waste or protect correlative rights. The dominant premise of L.O.'s application was that it lacked the funds to equip the well with a pumping unit. The fact that L.O. cannot afford to equip the well for pumping production is not a substitute for proper technical evidence submitted to meet the requirements of Rule 21(k)(1)(B)(iii).

An operator must present evidence addressing six issues outlined in Rule 21(k)(1)(B) to meet the minimum requirements for an exception to produce a well by swabbing, bailing or air jetting. The operator must show: 1) the method of production; 2) the production accounting method; 3) that the exception is necessary to prevent waste or protect correlative rights; 4) that wellhead control is sufficient to prevent releases from the well; 5) that the production method for the well is safe and will not result in pollution; and 6) that it has good faith claim of a right to operate the well.

L.O. established five of the six mandatory requirements under Rule 21(k)(1)(B). First, it outlined an air-jetting method to produce the well. It showed that any production will be through a flow line into a tank battery on the subject lease. Wellhead control was shown to be sufficient to prevent any releases from the well. Air-jetting the well will not result in pollution or a safety hazard. The July 25, 2003 lease constitutes a good faith claim of a right to operate the Brown No. 4 well. However, the evidence presented by L.O. that an exception is necessary to prevent waste or confiscation was based on its plea that it cannot afford to equip the well for pumping production.

The argument that an exception to Rule 21 is necessary as the only economic method for a particular company to produce any remaining reserves was raised in the only swabbing application the Commission has considered, *Oil & Gas Docket No. 01-0234805: Application of Caltex Energy Co. to Consider an Exception to Statewide Rule 21 to Allow Production by Swabbing, Bailing, or Jetting on the B.P. Rollert (01141) Lease, Various Wells, Luling-Branyon Field, Caldwell County, Texas*, hereinafter referred to as the Caltex (Rollert) case. The Caltex (Rollert) case noted:

It is difficult to assess whether this economic waste argument concerning pumping production satisfies the standard required under Rule 21. The argument relies on several assumptions regarding production, reservoir behavior, operating costs, and future prices of oil and natural gas, which, while commonly used in the industry in evaluating projects, leave little margin for error, especially when such a small amount of hydrocarbons is involved.

The determination in the Caltex (Rollert) case was that swabbing had the potential to produce 16,000 barrels of oil which would not be produced by pumping production based on the behavior of the reservoir. Accordingly, temporary authority was provided to Caltex to either prove or disprove that swabbing over an extended period of time would prevent actual waste.

In contrast to the Caltex (Rollert) case, L.O. did not submit technical evidence that air-jetting will potentially produce more oil than pumping. In the Caltex (Rollert) case, the Commission required competent technical evidence presented by a qualified expert before it approved swabbing as a production method on a lease that had not been previously produced by swabbing. L.O. presented no technical analysis or qualified expert testimony concerning: 1) the reservoir characteristics of the Marsha Field; 2) any estimate of the remaining recoverable reserves underlying the subject lease; or 3) a chemical analysis of the paraffin content of any produced oil. Additionally, L.O. itself suggested that the well could be equipped to produce up to 30 bopd on pump, a finding which was adopted by the Commission when it entered the superceding order rescinding the requirement that the well be plugged.

In sum, L.O.'s application is limited to an appeal to use air-jetting as a production method because L.O. cannot afford to properly equip the well. L.O. claimed that it would cost \$40,000.00 to equip the well with new equipment and that it lacked the funds to purchase that equipment. However, L.O. also submitted evidence that it has fully equipped wells completed in the same formation. No explanation was given to show why L.O. could not move equipment from its other wells, or simply purchase used equipment for the Brown No. 4 well.

L.O.'s request that it receive an exception to air-jet the well because it cannot afford to properly equip the well fails to satisfy the explicit requirement of Rule 21(k)(1)(B)(iii) that an operator show that the proposed exception is necessary to prevent waste or protect correlative rights. The fact that a particular company lacks sufficient capital to equip a well does not establish that a well will be abandoned and waste will occur. Further, this position is inconsistent with both L.O.'s prior representation that the well could be restored to 30 bopd of pumping production, and its assertion in the instant application that the well was capable of producing 150 barrels per month.

Additionally, L.O.'s argument that an exception is necessary to protect correlative rights is nonsensical and similarly unsupported by the evidence. L.O. did not estimate the remaining reserves underlying the subject lease. Further, it admits that there are no competing wells in the same field, which precludes a finding that the subject lease is being drained. Finally, L.O. already possesses the opportunity to protect any correlative rights by producing the well through conventional means.

Because L.O. failed to make the required evidentiary showing under Rule 21(k)(1)(B)(iii) that an exception was necessary to prevent waste or protect correlative rights, it is not necessary to consider any of the discretionary requirements under Rule 21(k)(2). Accordingly, the examiners recommend that L.O.'s application be denied.

Based on the record in this docket, the examiners recommend adoption of the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

1. L.O. Oil and Gas, L.L.C. (hereinafter "L.O.") was given at least 10 days notice of this proceeding. L.O. appeared at the hearing and presented evidence.
2. L.O. filed its first Commission Form P-5 (Organization Report) with the Commission on July 10, 2003. L.O. has posted financial assurance with the Commission in the form of a \$25,000 Letter of Credit.
3. Well No. 4 on the Brown "B" (13725) Lease (hereinafter "subject lease" or "Brown No. 4") was drilled by Avian Tech International, Inc. to a total depth of 2430 feet. The well was perforated and completed on May 14, 1993 in the Marsha Field.
4. L.O. was recognized by the Commission as the operator of the subject lease pursuant to the Final Order entered in Oil & Gas Docket No. 01-0235777 on October 21, 2003.
5. On July 25, 2003, L.O. obtained a lease from the current mineral interest owner with a three year primary term.
6. L.O. restored flowing production in the Brown No. 4 by injecting compressed air in the well, a production method commonly referred to as "air-jetting". The well is connected by flow lines to a tank battery and L.O. produced approximately 140 barrels of oil over a six week period by air-jetting the well.
7. L.O. failed to establish that air-jetting the Brown No. 4 well would prevent waste or protect correlative rights.
 - a. L.O. admitted the well could be reequipped and restored to pumping production, but claimed it lacked the necessary funds to properly equip the well.
 - b. Based on L.O.'s own testimony, the Commission found in Oil & Gas Docket No. 01-0235777 that the Brown No. 4 well could be restored to 30 bopd of pumping production.
 - c. L.O. admitted that the well was capable of producing 150 barrels per month on pump.
 - d. No technical analysis was presented concerning the reservoir characteristics of the Marsha Field.

- e. Although a gravity survey was submitted, no estimate of the remaining recoverable reserves underlying the subject lease was presented.
- f. No chemical analysis of the paraffin content of any produced oil was presented to establish the claim that paraffin build-up would impair pumping production.

CONCLUSIONS OF LAW

- 1. Proper notice of hearing was timely issued to the appropriate persons entitled to notice.
- 2. All things necessary to the Commission attaining jurisdiction have occurred.
- 3. L.O. failed to submit sufficient evidence to show that an exception to Statewide Rule 21 to produce the Brown No. 4 Well by air-jetting is necessary to prevent waste or confiscation.

RECOMMENDATION

The examiners recommend that the Commission deny the application of L.O. Oil and Gas, L.L.C., for an exception to Statewide Rule 21 to allow production air-jetting of Well No. 4 on the Brown "B" (13725) Lease.

Respectfully submitted,

Mark J. Helmueller
Hearings Examiner

Thomas H. Richter
Technical Examiner